THE UTILITY OF SPECULATION IN MODERN COMMERCE.

IT has been the farmer in the United States who has cried the loudest against speculative dealings in agricultural staples. His protest was heard most shrilly in 1890 and 1891, years of relatively low prices for farm produce, but with the return of "better times" in the great grain-growing states, his demand for legislative suppression of dealings in futures was a little less pronounced. Within the past few years, however, a portion of the press, as well as certain politicians and other public men, have been manifesting a very tender interest in the farmer — much such an interest as was previously shown for the workingman in our manufacturing industries. It is now the agriculturist who is to be convinced that this or that political party is best suited to become his economic Moses. As a result of this interest merchants and speculators two years ago were obliged to institute an educational campaign at Washington to defeat an economic monstrosity known as the Butterworth Bill, and more recently they have been engaged in a like public service in connection with the Hatch and Washburn Bills. The projects embodied in these bills are an outgrowth of (1) ignorance of the place and function of organized speculation; (2) misinformation with respect to legitimate speculation and its operation; and (3) demagogism pure and simple: and the measures have been fostered by those who regard trades in "futures" of wheat, cotton and other staples as "gambling," and the operators as dealers only in "wind" products. The primary object of all these bills is to prevent any one from contracting to deliver at a future date that which he does not possess at the date of making the contract.

The history of commerce contains numerous instances of fruitless assaults on "speculation." A Dutch law, as long ago as 1610, fifty-four years before the panic which visited Amsterdam in 1764, forbade the sale of securities not possessed by the

seller at the time of the sale. An English law of 1697 declared transactions for delivery more than three days ahead to be illegal. "Options" in English government securities were prohibited in 1834, and as late as in 1867 an act was passed by Parliament prohibiting "bear" or "short" sales of bank shares. Both these acts were directed against selling securities prior to acquiring them — a practice which it was thought had unfavorably affected the national credit. In England and in Germany the gambling act, it is said, can still be pleaded by unfortunate "short-sellers," but the act is inapplicable to any transaction by duly authorized agents at the London Stock Exchange. Selling gold "short" was forbidden by act of Congress in the United States twenty-eight years ago, but the act was promptly repealed,[1] owing to its unfortunate and unexpected effects. Operations "for the account" in public funds and railway shares were declared illegal in Prussia in 1836, in 1840 and in 1844, but the acts were repealed in 1860.

When it is recalled that during the past two centuries leading nations have been visited with commercial crises or financial panics at intervals on the average of about twenty years, entirely irrespective of such laws as the foregoing and irrespective of organized speculation, it must be inferred either that such laws were useless *ab initio* or that some counter-influence prevented their successful operation. In the absence of data justifying the latter alternative, the conclusion is inevitable, and is corroborated by the frequent repeals of such laws, that they have not met the expectations of their advocates. On the other hand, the history of commerce warrants the belief that were all laws repealed which seek to restrict the freedom of contract and were encouragement offered to organized speculative markets, the "short-seller," or "bear," would be found to be the safety-valve in the machinery of investment and speculation, — a check upon investment and a regulator of price-movement to an extent which the general public have not yet learned fully to appreciate.

[1] The original act was approved June 17, 1864; the repealing act, July 2, 1864, just fifteen days later.

The "investor," in any commercial or industrial line, may be compared with a "bull operator" who expects and intends to profit by reason of making the property productive; that is, a bull operator may be an investor, and *vice versa.* The speculator who is not an investor (nor a "bear") is one who makes a purchase in the expectation of profiting from an increase in the value of the property rather than through its being made productive. Speculation at organized commercial exchanges, such as the Chicago Board of Trade or the New York Produce Exchange, consists in transactions by the so-called bull and the "bear," or "short-seller." The former buys, or contracts to buy, (say) wheat, on any day within the current or some future month on which the seller (generally) may elect to deliver the same; that is, at the seller's "option" as to the particular day within the month. This form of trading has thereby come to be known as dealing in "options," though "futures" is a more appropriate term. Contracts covering trading of this variety, whether in wheat, corn, oats, cotton, pork, bacon, lard or petroleum, involve in every instance the actual delivery of the property sold and the acceptance of and payment for the same by the purchaser; and the default of the seller to deliver or of the buyer to accept and pay for the property renders the one so defaulting liable for breach of contract. When the appellation "gamblers" is applied to those who deal in this manner, it may express the private view of the person using the term; but in law and in fact such transactions do not constitute gambling.

In a little volume entitled *Futures*, by Julius Aroni, of New Orleans, there is reference to a very instructive case, Brown *vs.* Speyers, 20 Grattan 296, decided in 1871. The plaintiff, a gold broker in the city of New York, was employed by the defendant, residing in the city of Richmond, to buy and sell gold on commission for him in the city of New York. The transactions proved unfortunate, resulting in a loss to the defendant of about $4000, which plaintiff paid, and to recover which he instituted this action. The defendant insisted that the agreement between him and the plaintiff, his broker, was

wagering, and also that the sales and purchases made by the plaintiff were void. The learned judge who delivered the opinion of the court said:

"It is objected, however, that the contract which is the foundation of the action is a mere wager and void as such, under the provisions of the Virginia statutes. I cannot perceive the force of this objection. By the very terms of the arrangement the defendant in error, in buying and selling the gold, could sustain no loss, nor realize any profit from the transaction beyond his commissions, to which he was entitled in any event. Whatever might happen, no damage or benefit could accrue to him from the venture. If any profit resulted from the speculation, it belonged to the plaintiff in error. If any loss accrued, he was to bear it. And I have yet to see a case in which it has been held that a contract is a wager by the terms of which the loss and profit were all on one side. Another point relied upon in the argument is that no sales or purchases of gold were in fact made, and the subject-matter of such pretended purchases and sales had at the time no existence actual or potential and therefore, according to a well-established principle of the law of sales, the contract in relation thereto was void in law.

But the judge proceeds to say that the question could only arise between the vendor and the vendee and could not affect the rights of the plaintiff, who had simply acted as the agent of defendant in the case then before the court.

In order to make plain other points involved in the question of the legality or illegality of speculative contracts, one more decision may be referred to, that by Judge Bunn, of Wisconsin, in the case of Clark *vs.* Foss, reported in 7 Bissell 540, and summarized as follows in the work referred to above:

1. A contract for the delivery at a future time of personal property which the seller has not on hand when the contract is made, nor any means of getting it, is not void for illegality;

2. The secret intention of one of the contracting parties not to fulfil his contract, uncommunicated to the other, is not enough to make the transaction illegal;

3. The intent that such a transaction should be a mere betting on the market, without any expectation of actual performance, must be mutual and constitute an integral part of the contract, in order to render it invalid;

4. If the contracts were valid in their inception and not tainted with any gambling intent or device, a subsequent mutual settlement by the parties by payment of differences instead of by actual delivery cannot make them void for illegality.

I have been at some pains to quote from legal decisions covering the several varieties of contract recognized by the commercial exchanges, even those settled by payment of differences, because there is such a wide-spread ignorance of the fact that the highest courts of the various states and of the United States have time and again certified to their legitimacy and legality. Even the statistician of the Agricultural Department goes so far as to intimate in an official publication that speculation at the Chicago Board of Trade, the New York Produce Exchange and like bodies is something apart from legitimate business. And the same view is entertained by the gentlemen whose names are used to designate the bills touching the subject, as well as by many other persons in official life. Following in the train of these gentlemen are thousands of other good people who appear to be pestered with such reasoning as the following:

Because it is easy to offer and agree to sell that which one has not;

Therefore, there is naturally a predominance of sellers in speculative markets:

And, as free offers to sell tend to lower prices;

Therefore, the existence of this freedom of short selling has the effect of "unduly depressing" prices.

And then follows the easy conclusion that the farmer is "robbed" of a portion of his just dues by bear speculators.

As a matter of fact the seller-short is consciously or otherwise a friend of the public, farmer as well as general consumer; for without him both would suffer from excessive fluctuation in prices far more than at present. The difficulty in getting the public to understand this is largely due to the intricacy of the mechanism of speculation, which is not generally understood — particularly the phenomena of selling short. Even so learned a body as the House committee which recently reported in favor of the passage of a substitute Anti-Options

Bill went so far as to quote from a number of newspaper reports of the wheat market to show, apparently, that short-selling "unduly depressed" prices. The main reliance was on such statements as the following:

The market broke sharply under the pressure of short-selling.

The Chicago bear ring has finally succeeded in creating a panic throughout the world.

All the energies of the trade have been directed to breaking down the price of wheat.

Pardridge, who has been so successful on the bear side. . . .

Pardridge said . . . he had made four times as much out of his bear campaign, [*etc.*]

The man who is just now dominating the markets.

The milling and shipping demand was about sufficient to absorb current offerings, . . . yet the price [of cash or spot wheat] followed the price of futures down.

[Quoted from an individual trader:] It is apparent that the operations of one big bear like Pardridge are more influential than low prices and the fear of crop danger.

The "manipulations" referred to in the foregoing were characterized by the House committee as "flagrant and destructive of the interests of the producer." In reply it only needs to be said that if Mr. Pardridge or any other short-seller had been wrong in his views as to the world's supply and demand of wheat, on which the price must in the long run depend, Mr. Pardridge, or whoever he might be, would have been unable to make good his contracts except at a loss, and so would have cornered himself and probably suffered bankruptcy. The success of the speculator named was directly dependent upon his contracting in the winter months of 1891–92 to deliver millions of bushels of wheat in the spring months of 1892 at prices which seemed disproportionately low to those who believed in a nominal shortage in the world's supply, — and they were about ninety-nine out of every hundred who had opinions to offer. He stood by that conclusion, the supply of wheat proved more than ample and he made money, while the general public enjoyed cheaper flour sooner than it would have secured it without his assistance. He has proved, so far as the cereal year 1891–92 is concerned,

that he was correct; and whether his actions were due to special information, intuition or accident, he was the first to demonstrate that there was in existence somewhere more wheat to meet the demands of importing countries than any official or unofficial bureau of information had been able to discover. When he sold wheat late last winter for May delivery at eighty cents, a price absurdly low in the general estimation, he was not unduly depressing the price. He was putting quotations for May *where they should have been.* Of course, he may not have known, as he now does, that he was absolutely right, though he expressed that view from first to last. Had he been unduly depressing the price, the outcome would have been different. He would long ago have found the world's demand for wheat so great that his so-called "wind" wheat sales would not have been able to "force prices down"; he would have been obliged to "run to cover," to pay a very high price for wheat to make good his deliveries, and would have been so anxious to get the grain that the price would not only have rapidly advanced, but in all probability would have been inflated temporarily to a point above the actual value.

Had there been no facilities for organized speculation in foodstuffs last winter, in the presence of the prevalent misinterpretation of the supply of wheat, with only the milling, shipping or exporting demand to influence prices, as in the "olden days," quotations would have been excessively inflated,—doubtless much to the delight of the farmer, but to the severe cost of the unconsidered but more numerous general consumer. As a matter of fact, Mr. Pardridge, or, if you please, the "bear crowd," put the price of wheat where it belonged, from the point of view of its statistical situation; they did that which neither the national Agricultural Department, the Vienna Congress, *Bradstreet's*, the Cincinnati *Price Current*, Beerbohm's or Dornbusch's (London) *Lists*, or any other of the governmental and private statistical bureaus of the world had been able to do: they proved the existence of unsuspected and relatively abundant supplies. If, by reason of supplies being shorter than they really were, the short-sellers had not succeeded, they would have

bankrupted themselves, but at no cost to any one else; and the price of wheat for a time would have gone somewhat higher than the normal, thus affording those who had suffered from undue depression — the bulls — an opportunity to prove that they were right and incidentally to recoup their losses.

The foregoing indicates, among other things, that much of the current comment in daily market reports is misleading to the average reader; it certainly was to the House committee which had the Anti-Options Bill under consideration. These estimable gentlemen took too literally the remarks as to what tended to "unduly depress" prices, the incident forming a sufficient comment on the lack of information concerning the function and influence of speculation among some of those whose business it is to record its movements.

The end of speculation in the great staple corps, the production of which cannot be artificially regulated so that it will exactly satisfy the world's demand, is to furnish:

(1) A continuous open market;

(2) A measure (the best sense of the commercial world) as to the value of products from day to day; and

(3) The machinery for carrying surplus crops from prolific to lean seasons.

By securing these ends, and by the creation of standard or contract grades, speculation renders the staple product a better security at lower rates of interest on which to obtain loans at all times; and by minimizing the cost of carrying surpluses from month to month or from season to season, it enables the producer to sell to the best advantage.

Without organized speculation as it now exists at Chicago, New York, Minneapolis, St. Louis, Toledo and elsewhere (abroad as well as at home) we should have to return to the old-time practices by which the enterprising or "sharp" individual profited more relatively than he does to-day at the expense of one less experienced or well-informed; the comparatively few millers and exporters would have the thousands upon thousands of producers or holders at their mercy; the price of wheat would become local instead of being based at all points on its value in

the world's markets; in the absence of a continuous open market bankers would not lend on grain readily or at as reasonable rates as they now do, and the carrying over of surplus crops from one season to the next would result in undue profits and excessive losses.

Organized speculation in grain (as in other agricultural products) is a part of the modern machinery of trade — as real and essential a part as is the locomotive, the steamship or the telegraph. When the time arrives that the output of a staple manufactured article is enormously in excess of demand in some countries and has to be carried over, to an extent, to meet foreign demand, organized speculation in manufactured products may become successful — but not until then. We have seen an illustration of this in speculation in Scotch pig-iron warrants. As manufactured products may be produced practically irrespective of climate, drouths, rains, character of the soil, *etc.*, and, within certain limits, irrespective of the points where the raw materials are produced, it follows that demand for and supply of such products may ultimately be adjusted. There is thus a far greater need for the machinery of speculation in agricultural than in manufactured staples.

Trading in futures has been evolved by the necessities of modern commerce, and if checked here it will be carried on abroad. No one community can permanently prevent the employment of so essential a piece of commercial machinery, and the attempt to do so may be likened to efforts which have been made to check the use of labor-saving devices.

The selling for future delivery what one does not possess at the time of sale, has always been and is everywhere to-day a part of commercial life. Men contract to supply a new building when the materials of which it is to be built are not in existence; the retail dealer buys goods which he merely expects and hopes to be able to sell again; jobbers and importers "go short" every day by selling that which they do not possess, but which they fully expect to be able to obtain at a time and at a price which will enable them to make the delivery at a profit. The mill owner, too, buys futures of cotton, and sells futures of cloth

to the jobber and of prints to the commission merchant. Could the latter pay the cotton planter his (the planter's) share for the cotton in the cloth, and the mill owner his share for manipulating the fibre, that would constitute the "ringing out" process, which so many have failed to understand and have decried as gambling. Coal dealers buy and sell futures of coal on the basis of an estimate of probable sales; and jobbers, who dispose of goods "by catalogue," are short-sellers of the most pronounced type.

The claim (by the Minneapolis *Tribune*, June 28, 1891) that there is no need for short sales, completely loses sight of the fact that they are our only salvation from an unwarranted inflation of prices. It was the bears who sold so freely in advance of their holdings to Mr. James R. Keene, and broke his "corner" at Chicago some years ago by proving that there was more wheat in the country than Mr. Keene had suspected; by doing so they brought prices back to the normal long before they could have gotten there without such aid. For that matter, were it not for the bears, the Keene corner would have been successful. But short sales do not always result in putting prices down. The bears often advance prices against their wishes by having to buy to protect themselves, as Mr. Pardridge would have had to do, had he been wrong and the rest of us right as to the world's wheat supply and demand this year. If, as has been declared, the "shorts" depress prices unduly, supplies would leave for some other of the world's markets, the price being ultimately determined by supply and demand.

The insurance against excessive loss on purchases of futures of wheat by sales of like quantities for future delivery has grown to enormous proportions both here and abroad and constitutes a feature of speculative dealings in grain long since recognized as a necessity. A Liverpool merchant orders a cargo of wheat from San Francisco; it is purchased and shipped and will arrive out some months hence. Meanwhile he sells by cable at New York, for instance, a like quantity for delivery in the month in which his wheat is due to arrive at Liverpool. Should the price of wheat decline while his San

Francisco cargo is *en voyage*, he buys in enough wheat at New York to make good his delivery there and the profit at New York offsets a loss due to the decrease in price of the wheat which arrived at Liverpool. Like transactions in insurance are made by millers, shippers and others throughout this country. As the Minneapolis *Market Record* pointed out October 20, 1891:

> This trading . . . is chiefly based on sales against country purchases on the one side and purchases against flour sales on the other. . . . Before this business was organized (at Minneapolis) the trading was all in outside places. It had to be done somewhere, for no elevator company would dare to pile up millions of bushels of wheat in country houses or terminal houses even, unprotected by sales for forward months. They would find it difficult to maintain a standing in financial circles without such provision for safety against possible changes in values. The business done in grain for forward months has a strengthening influence upon the prices paid for grain in the country, as it removes risk and allows buyers at country stations to figure up closely, not having to provide for what would otherwise be a fruitful source of loss. It is not a mistake to say that half the old-time margin, at least, has been wiped out since the change in methods.

The successful speculator must have accurate knowledge from every available source. Being successful, he has merely foreseen causes which made prices go up or down, though his operations may have tended to make prices rise or fall more rapidly than they would otherwise have done; for should he operate counter to underlying and omnipotent price-making influences, he pays the cost himself. His work, therefore, merely quickens and emphasizes the laws of trade, in discounting the future price of an article based upon prospective commercial conditions.

There is, of course, another variety of "speculator," — he who cares little and knows less about supply and demand or stocks or prices or exports; he spends his time buying when the real speculator buys and selling when the latter sells. But he does not count for much; he cannot well be obliterated, but he does no harm except to himself.

The farmer should not forget that speculation gives a present value to commodities when the market is stagnant — when the

agriculturist would otherwise find his produce unsalable at any price; and the merchant may as well have it called to his attention that speculation helps business generally by reason of the connection between the latter and the activity stimulated by it in certain commodities.

The excess of speculators, who are bound to work to the common welfare or pay a fine to the amount of their investments or contracts, serves merely to emphasize the operation of speculative transactions to the various ends described; and a speculative demand with the short-selling safety valve is thus created, which is sufficient to absorb the surplus yields of wheat, cotton, corn or oats, and to carry them until wanted and place them where most needed at the lowest prices consistent with the world's supply and demand.

In this age of highly developed business activity, the world's real speculators are the Arkwrights, the Frémonts, the Stanleys and the Edisons of trade, with the added qualities of those whose brains, resources and energy have utilized the discoveries of these vanguardsmen.

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